

## Internal Revenue Service

Number: **201451004**

Release Date: 12/19/2014

Index Number: 165.00-00, 453.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B01

PLR-109117-14

Date:

September 03, 2014

Taxpayer =  
State =  
B =

Date1 =  
Date2 =  
Company =  
C =  
D =  
E =  
Year1 =  
Date3 =  
F =

Buyer =  
G =  
H =  
J =  
K =  
Date4 =  
L =  
Year4 =  
M =  
N =  
P =  
Q =  
Year2 =  
R =

S =  
T =  
Year3 =  
V =  
W =

Dear :

This letter responds to your letter dated February 3, 2014, and subsequent correspondence, on behalf of Taxpayer, requesting a ruling on the proper application of §§ 165 and 453 of the Internal Revenue Code to Taxpayer's transaction.

### **RULING REQUESTED**

Taxpayer will be permitted to claim a loss deduction under § 165 with respect to Taxpayer's sale of its interest in Company for the taxable year ended Date4, except to the extent of L.

### **FACTS**

Taxpayer is a State limited liability company engaged in the business of B. From Date1 through Date2, Taxpayer invested in Company by issuing secured convertible promissory notes and satisfying the principal and interest of those promissory notes through the issuance of new secured convertible promissory notes of similar terms charging interest of C, and convertible into D.

By the middle of Year1, Taxpayer, as majority-in-interest of the lenders, decided that Company needed to be sold in order to recoup its investment. Taxpayer directed Company's management to initiate the sale process.

On Date3, Company, F, and Buyer entered into G, whereby Company would merge into a subsidiary of Buyer. Immediately prior to the merger, Taxpayer converted its outstanding promissory notes into equity in Company. After the conversion, Taxpayer owned H% of Company. Pursuant to G, Buyer paid \$J at closing, with several amounts due after closing, including, among other items, a maximum earn-out of \$K to be paid based on several milestones Company was to achieve by the end of Year3, and L, to be paid in Year4, provided M.

On its Year1 federal income tax return, Taxpayer reported the sale of Company on the installment method under § 453 as a contingent payment sale. Based on the terms of G, Taxpayer determined its share of the stated maximum selling price to be \$N. Taxpayer received \$P proceeds in Year1, and reported \$Q in income under the installment method for Year1.

In Year2, events occurred that reduced the maximum selling price to \$R. Taxpayer received \$S in Year2, and reported \$T in income under the installment method in Year2.

In Year3, the earn-out period expired before Company achieved any milestones, reducing the maximum selling price again to \$V. Taxpayer represents that \$V is less than its basis in the stock it sold, and thus the transaction is now a loss transaction rather than a gain transaction. Taxpayer did not receive any proceeds in Year3.

In Year4, Taxpayer expects to receive \$W, its share of L, provided M.

## **LAW AND ANALYSIS**

Section 453(a) provides that income from an installment sale shall be taken into account under the installment method.

Section 453(c) provides that the term “installment method” means a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit percentage (realized or to be realized when payment is completed) bears to the total contract price.

Section 165(a) provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated by insurance or otherwise.

Section 1.165-1(c) provides that the amount of the loss allowable as a deduction under § 165(a) shall not exceed the amount prescribed by § 1.1011-1 as the adjusted basis for determining the loss from the sale or other disposition of the property involved.

Section 1.165-1(d)(1) provides that a loss shall be allowed as a deduction under § 165 only for the taxable year which the loss is sustained. For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and fixed by identifiable events occurring in such taxable year.

Taxpayer correctly reported the sale of Company on the installment method under § 453 in Year1 and Year2. In Year3, however, the failure to achieve the earn-out milestones meant that the maximum amount paid or to be paid under G, \$V, was less than Taxpayer’s basis in the stock it sold, as represented by Taxpayer, resulting in a loss.

The taxable year during which Taxpayer sustained a loss is governed by § 165. In Year3, identifiable events occurred that established that the maximum remaining amount Taxpayer could receive under the terms of G was \$W. Accordingly, Taxpayer sustained a loss under § 165 during the taxable year ended Date4 to the extent its

unrecovered basis at the end of Year2 exceeded \$W, the maximum remaining amount it could receive as a result of L.

## CONCLUSION

Taxpayer may claim a loss deduction under § 165 with respect to Taxpayer's sale of its interest in Company in the taxable year ended Date4, to the extent its unrecovered basis at the end of Year2 exceeds \$W, the maximum remaining amount it is entitled to receive under G as a result of L.

## CAVEATS

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding the Taxpayer's basis in its stock in Company, its unrecovered basis at the end of Year2, or the method the Taxpayer used to determine its basis.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Andrew M. Irving  
Senior Counsel, Branch 1  
Office of Associate Chief Counsel  
(Income Tax & Accounting)